Annual Construction Industry Tax Update

VOS CFMA

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Presenter

Stephan King
CPA, PFS

Stephan King CPA/PFS is a sole practitioner based in Scottsdale, Arizona. He has spent 15 years with Moss Adams LLP before retiring in 2012. As a partner with Moss, he held a number of leadership roles including Phoenix Office Tax Leader.

Stephan has chaired the Arizona Society of CPAs Tax Steering Committee and Oregon-Springfield Tax Association. He is a frequent speaker on tax related topics.

Stephan is a graduate of the University of Hawaii and completed the University of Illinois National Tax Education Program. He began his career in Honolulu and worked for an Oregon regional firm before joining Moss Adams.

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Presenter

Glenn Conover
CPA, CCIFP, CEPA

Glenn Conover is a tax partner at Conover Asay, CPAs. Glenn has been a partner for 20 years and most of his 30+ year career has been spent in the construction, real estate and professional services industries. He consults with business owners and individuals providing services including general income tax services and planning and business exit planning. Tax planning is a critical aspect in the Concierge Accounting service approach at Conover Asay.

In 2018, Glenn was appointed to serve on the Tax Committee of the Arizona State Board of Accountancy.

Glenn received his Master's of Taxation degree from Arizona State University. He began his career at PricewaterhouseCoopers and was a partner at Moss Adams when they opened their Arizona office.

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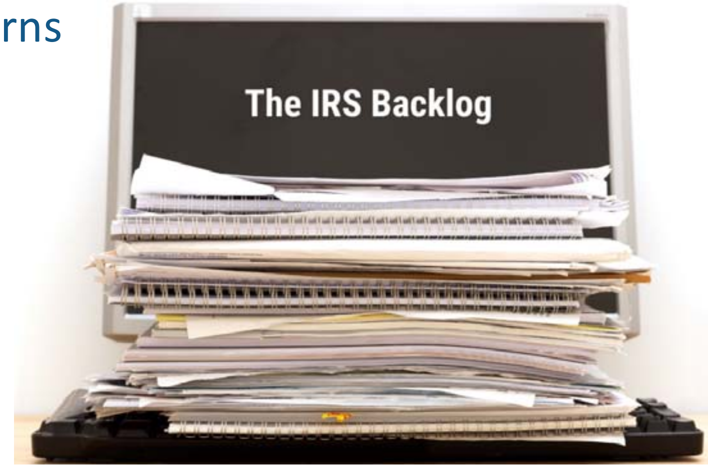
Agenda

Annual Construction Industry Tax Update

- Employee Retention Credit
- Meals & Entertainment
- ASC 606
- State & Local Taxes - Workaround
- Other
- Build Back Better

Amid Chaos, IRS Attempts A Return To Normal

- The Internal Revenue Service will kick off the approaching tax season with a backlog of at least 10 million unprocessed returns from last year ***(NY Times)***
- IRS delays triggered some premature collection notices ***(Washington Post)***
- National Taxpayer Advocate Report backlog ***(CPA Practice Advisor)***
  - *6 Million 1040s*
  - *2.3 million amended returns*
  - *2.0 million 941s and 941Xs*
  - *5.0 million pieces of correspondence*
  - *IRS phone service had gone from bad to worse*
- National Taxpayer Advocate reports IRS performed well under difficult circumstances ***(IRS)***



Employee Retention Credit (ERC) 2020

- A fully refundable tax credit for certain employers equal to 50% of qualifying wages that an Eligible Employer pays to their employees.
- The credit applies to qualified wages paid from March 13,2020 and before January 1, 2021. The maximum amount of credit for all quarters is based on $10,000 of qualified wages ($5,000 credit) per employee.
- PPP and ERC can be used by the same company (not the same wages)
- An Eligible Employer is one carrying on a trade or business (but also includes tax-exempt organizations) that either:
  - Fully or partially suspends operation during any calendar quarter in 2020 due to orders from an appropriate governmental authority due to COVID-19; or
  - Experiences a significant decline in gross receipts for a quarter - i.e., a 50% reduction for the quarter compared to the same quarter in the prior year.

Employee Retention Credit (ERC) 2021

- Increases from 50% of qualifying wages to 70% ($7,000 vs. $5,000)
- Limitation is quarterly vs. annual ($7,000 per quarter, $28,000 for year)
- PPP and ERC can be used by the same company (not same wages)
- Qualified reduction in gross revenue of 20%> for 2021 vs. same quarter in 2019 (was 50%> for 2020)
- Increases from 100 employees to 500 employees in 2021.
- Infrastructure and Jobs Act terminates ERTC for 4th quarter 2021 except for recovery startup businesses.

Employee Retention Credit (ERC) 2021

- Qualification in previous quarter allows credit for following quarter (if qualified in 2nd quarter 2021, also qualify for 3rd quarter)
- Some limitations on wages paid to stockholders and family
- Credit is "taxable" in the quarter it is earned (accrue at year end)

Final Regulations on the Deduction for Meals and Entertainment

- The 2017 TCJA generally eliminated the deduction for any expense related to activities generally considered entertainment, amusement or recreation.
- These final regulations address the disallowance of the deduction for expenditures related to entertainment, amusement or recreation activities, including the applicability of certain exceptions to this disallowance.
- They also provide guidance to determine whether an activity is considered entertainment. The final regulations also address the limitation on the deduction of food and beverage expenses.

Per Diem, Travel, Meals & Entertainment

- Entertainment is non-deductible
  - Sporting events, golfing, theater tickets
- Meals 100% and 50%
  - For expenses incurred between 01/01/2021 and 12/31/2022 for food/beverage provided by a restaurant – **100% deductible**
  - For prior to 12/31/2020 and 01/01/2023 and after valid business meals - **50% deductible**
  - Employee holiday parties, annual picnics – **100% deductible**
  - Meals provided employees on business premises for convenience of employer – **50% deductible**

Per Diem, Travel, Meals & Entertainment

- Per Diem
  - Rev Proc 2019-48 provides rules for taxpayers that choose to use a Per Diem rate for substantiation of Lodging, Meals and incidental expenses
  - Flat per diem rate cannot exceed the Approved Federal Per Diem Rate – www.gsa.gov
- Accountable Plans
  - Dollar for Dollar reimbursement of business expenses:
    - ✓ Business Connection, Substantiation, Excess Payments returned

Per Diem, Travel, Meals & Entertainment

Temporary Stay Rules

- If an employee is away from home on a job site for less than a year all travel and per diem payments are deductible by the company and non-taxable to employee.
- If the arrangement is for one year or more the travel and per diems are taxable to employee as additional compensation.
- Per diems become taxable at the point assignment is determined to last more than one year.

Traveling away from home is if:

- Your duties require you to be away from the general area of your tax home substantially longer than an ordinary day's work, and
- You need to sleep or rest to meet the demands of your work while away from home (does not include merely napping in your car)
- IRS looks at “home” broadly and encompasses a general vicinity (50 mile radius)

ASC 606 – New Revenue Recognition Standards

Variable Consideration (such as a performance bonus)

- Book purposes: income is recognized when it is probable the bonus will be received
- Tax purposes: income recognized in the total contract value when it is reasonably predicted the amount will be earned but should be recognized no later than when it is recognized for financial statement purposes

Claims Revenue (claims collection on a job)

- Book and Tax same treatment as for Variable Consideration

ASC 606 – New Revenue Recognition Standards

- Uninstalled Materials
  - Book: recorded as a job costs on the WIP but at zero margin (revenue will be increased to extent of the costs of uninstalled materials) when the materials are dedicated to the job or ordered specific for that job
  - Tax: recognized when the materials are dedicated to the job not when the materials are installed meaning: either delivered to a job site, ordered for a specific contract or unique and distinct to a contract

Adopting ASC 606 – New Revenue Recognition Standards for Tax Reporting and 451(b)

- IRC §451(b) requires a taxpayer with an applicable financial statement (AFS) who files federal income taxes using an overall accrual method of accounting, and is subject to the "all-events" test, to recognize revenue at least as quickly on the tax return as the entity does on the AFS.

SALT Cap Workaround

- ***IRS Notice 2020-75 - Green Light***
- Enabling pass-through entities to deduct entity-level SALT payments as business expenses in place of non-deductible itemized deductions over the "SALT cap" of $10,000.
  - Revised BBB Plan as of 11/3/21 - Increases SALT Cap to $72,500 for 2021
- Many states require elections, some by partner, and SALT PTE tax payments have due dates.
- Probably need to make a payment by December 31, 2021 to ensure deductibility on 2021 federal return.

Notice 2020-75

- SALT payments made by pass-through entities:
  - IRS will issue proposed regulations to clarify state and local income taxes imposed on and paid by pass-through entity are deductible by partnership or S corporation.
  - Purposes is to provide certainty to individual owners of the deductibility of those payments in arriving at taxable income. Therefore, not subject to limitation of $10K under the TCJA for 2017.

AZ Application of Pass-Through Taxes (2021)

- Senate Bill 1783 - allows individual taxpayers to ***elect*** to have their "Arizona small business adjusted gross income (SMAGI)" removed from their regular individual income tax return and taxed on a separate "Arizona small business income tax return." The rule is effective after December 31, 2020.

- SBAGI for residents means the sum of the amounts, whether positive or negative, that are included in a taxpayer's federal adjusted gross income for the taxable year…and that are reported on the following IRS forms:
  - Schedule B, interest and ordinary dividends.
  - Schedule C, profit or loss from business.
  - Schedule E, supplemental income or loss.
  - Schedule F, profit or loss from farming.
  - Form 4797, sale of business property.
  - Form 4835, farm rental income and expenses.

AZ Application of Pass-Through Taxes (2021)

- SBAGI includes any amount reported on Schedule D, capital gains and losses, that is recognized concerning either the taxable disposition of an ownership interest in any entity other than a publicly-traded entity, or the taxable disposition assets used the trade or business activity, including goodwill and going concern value.
- Electing small businesses are taxed at 3.5% verse their potential rate (maximum of 4.5%)
- Rate reduces annually by 2.5% after December 31, 2024.
- Credits are allowed for taxes paid to another state.

AZ Application of Pass-Through Taxes (2022)

- HB 2838 allows partners or shareholders of a business that is a partnership or S corporation to ***elect*** to be taxed at the entity level at a rate of 4.5% on the entity's Arizona taxable income as discussed further below.
- The election is required to be made on or before the due date or extended due date of the entity's return.
- The tax is levied on taxable income of ***individual*** resident owners from sources within AZ.
- The taxes paid by the entity for electing owners are includable in AGI of the individual resident owners.

Bonus Depreciation is allowed on Qualified Improvement Property (QIP) costs

- QIP is defined as any improvement made by a taxpayer to an interior portion of a nonresidential building placed in service after the building was placed in service
- QIP is eligible for 15-year depreciation vs 39 year
- The Legislative error in the TCJA (2017) is fixed and QIP is now eligible for immediate write-off.
- This provision is retroactive to 2018 and 2019

1099 K Reporting

- American Rescue Plan Act of 2021 recently modified IRC Section 6050W by lowering the threshold for Form 1099-K reporting on third-party network transactions.
- Currently, these organizations are not required to report third-party network transactions for a participating payee unless the amount to be reported exceeds $20,000 and the aggregate number of transactions with that participating payee exceeds 200.
- The law changes the threshold to $600 (for any number of transactions) effective for 2022 Forms 1099-K (due to be filed in 2023).

IRC Sec 179D
Energy Efficient Commercial Buildings Deduction

As part of the Consolidated Appropriations Acts, 2021 signed into law on December 27, 2020,

the energy efficient commercial buildings deduction (IRC Sec. 179D) is now made permanent.

- Available to owners, designers and builders
- Up to $1.80 per sq ft tax deduction for energy-based improvements
  - HVAC
  - Interior lighting
  - Building envelope
- Government agencies can allocate the tax savings to the designer or contractor

Construction Industry ATG

- The IRS issued the Audit Tax Guide for the construction industry in April 2021.
- Audit Guide outlines Treasury’s position on various tax issues including:
  - Confirms that overbillings taxability for accrual basis taxpayers
  - Accrual less retention is an allowable method for receivables and payables
  - Outlines 95% completion standard for completed contracts
  - The allocation method for direct and indirect completed contract cost.
  - BOLI for uninstalled materials
  - Confirms definition of residential contracts for certain congregated living facilities

Construction Industry ATG

- Under audit IRS will include claims, bonuses, and disputed compensation in cost, if included in financial statements
- ASC 606 revenue recognition for AFS vs. tax revenue
- IRS has list of expected book/tax differences including
  - Loss contracts
  - Uninstalled materials
  - 10% method exclusion

Build Back Better Plan

House Ways and Means 11/19/21

Individual provisions

- New surcharge on high-income individuals - Effective 1 /1 /22
  - 5% surcharge on an individual's modified adjusted gross income in excess of $10M ($5M for MFS or $200k for estate or trust)
  - Additional 3% surcharge (8% total) on modified adjusted gross income in excess of $25M ($12.5M for MFS or $500k for an estate or trust)
- 3.8% Net Investment Income Tax to apply to trade or business income for taxpayers with taxable income over $400k (single filers) $500k (MFJ)
- Prohibits further contributions to Roth or Traditional IRA when total value of IRA and defined contribution retirement accounts exceed $10M. Applies when income is over $400k (single), $425k (HoH), $450k (MFJ)
- Prohibits all after-tax contributions in qualified plans and after-tax IRA contributions from being converted to a Roth IRA regardless of income level starting 1/1/22

Build Back Better Plan

House Ways and Means 11/19/21

- **Corporate provisions**
  - Impose a 15% Alternative Minimum Tax (AMT) on adjusted financial statement income of applicable corporations that report over $1 Billion in profits to shareholders.
  - 1% surcharge on corporate stock buybacks for public companies

- **Notable items not in BBB bill but that were on Biden's campaign website**
  - Increased Long-Term Capital Gain and Qualified Dividend Rate
  - Limitation on QBID
  - Increase in top individual tax bracket to 39.6%
  - Increase to Corporate tax rates